

DEPARTMENT OF NATURAL RESOURCES AND CONSERVATION

Trust Land Management Division



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November 11, 2005

MEMORANDUM

TO: Joe Kolman, Research Analyst, Legislative Services Division

FR: Monte Mason, Minerals Management Bureau Chief
Trust Land Management Division

RE: HB790 Questions

Per your November 9, 2005 email, the following information may help clarify our process regarding surface agreements.

Operations on state oil & gas leases are governed by applicable statute, administrative rule and lease contract requirements. The Trust Land Management Division (TLMD) within the Department of Natural Resources and Conservation manages state school trust lands under the direction of the State Land Board. Oil and gas operations, whether on state or privately owned lands, are also regulated by the Montana Board of Oil and Gas Conservation (MBOGC). Review and approval of operations is subject to the Montana Environmental Policy Act.

Title 82, Chapter 10, Part 5, Montana Code Annotated, provides the scope of responsibilities an oil & gas operator has to the owner or tenant of the surface estate. A copy is attached. For operations on state-owned lands, TLMD administrative rules also provide guidance. ARM 36.25.217 addresses the responsibilities of our oil & gas lessee on state land:

36.25.217 OPERATIONS ON STATE LEASES (1) The lessee shall conduct all operations subject to such inspections as the department shall decide to make and shall carry out at the lessee's expense all reasonable orders and requirements of the department relative to the prevention of waste and preservation of property. On the failure of the lessee to do so, the department shall have the right, together with other recourse herein provided, to enter on the property to repair damages or prevent waste at the lessee's expense.

(2) In all operations on lands leased pursuant to these rules and regulations, the lessee shall use the highest degree of care and all proper safeguards to prevent pollution of earth, air or water by hydrocarbons or other pollutants, excepting that pollution which is allowed, if any, by these rules and regulations and the rules and regulations relating to oil and gas published by the oil and gas conservation division of the department. In the event of pollution, directly or indirectly caused by lessee's operations on lands leased pursuant to these rules, lessee shall use all means at its disposal to recapture escaped hydrocarbons and other pollutants and shall be responsible for all damage to public and private properties, including bodies of water of any sort, whether above or below the surface of the earth.

(3) To minimize conflicts with the owner or lessee of the surface of the land leased, lessee hereunder shall:

(a) provide the surface owner or lessee with a plan for location of all facilities;

(b) consult with the surface owner or lessee regarding a reasonable location of access roads. The access roads must be located along section lines and existing roads to the fullest extent possible and they must disturb as little acreage as possible unless the surface owner agrees otherwise. In locating the roads, priority shall be given to minimizing interference with the surface owners or lessees operations. The lessee shall make just payment to the surface owner for all damage done by reason of his entry upon, and use and occupancy of, the surface of the land.

(4) When any oil or gas well drilling operation is commenced on land leased pursuant to these rules, any topsoil on affected lands shall be removed and stockpiled on the site. The lessee shall take all reasonable, necessary steps to insure the preservation of the stockpiled topsoil including a temporary vegetation cover to prevent erosion. At the completion of oil or gas recovery operations, and upon the final abandonment and completion of the plugging of any well, the lessee shall, unless the owner of the surface requests otherwise and executes a release to that effect, restore the surface of the location to its original contours as far as reasonably possible, redistribute the topsoil, and reseed the land with native grasses and/or native plants as prescribed by the department.

ARM 36.25.138 addresses the scope of our surface lessee's rights when an oil and gas lease operation is proposed:

36.25.138 LESSEE OR LICENSEE DAMAGE COMPENSATION REQUIREMENTS

(1) When the board or department issues a lease or license on property upon which a lease or license of a different type already exists, the existing lessee or licensee shall be compensated by the more recent lessee or licensee for damages to the crops, improvements or leasehold interest of said existing lessee or licensee. Lessees or licensees may not receive compensation for such damages in excess of the value of actual damages to the crops, improvements or leasehold interest of said existing licensee. Only in exceptional cases documented to and approved by the department may the lessee or licensee receive damages for natural resources or crops in excess of the annual rate that the lessee or licensee is making to the department for rental payments. If a lessee or licensee collects or attempts to collect an amount in excess of said actual damages, such action may constitute sufficient grounds for cancellation of the lease or license. The department may adjust the AUM's allocated to a grazing lease or license when there is issued a lease or license for another purpose and that other purpose interferes with the grazing on the state lease.

A State of Montana oil & gas lease is attached. Pertinent provisions from that lease contract are as follows:

28. SURFACE OWNER'S OR LESSEE'S RIGHTS--The lessee hereunder agrees to provide the surface owner and surface lessee with a plan for location of all facilities and consult with the surface owner and surface lessee regarding a reasonable location of access roads. In all operations on the land hereby leased, lessee agrees to interfere as little as possible with the use of the premises for any other purpose to which the same may be devoted by other persons to whom the land may have been leased or sold by the State. The lessee shall not drill any well upon the lands hereby leased, within two hundred feet (200') of any residence or barn now or hereafter erected thereon without the consent of the owner of such building. The lessee hereby agrees to make satisfactory adjustment with the owner or lessee of the surface, including the State of Montana, for damages sustained by such surface owner, the lessee, or the State of Montana by reason of the lessee's entry upon, use and occupancy of, the surface of the land. If amicable determination of damages cannot be made between such surface owner, lessee, or the State of Montana and the lessee hereunder, then, upon the agreement of the surface owner or lessee to enter into arbitration, the damages to be paid to the surface owner or lessee shall be fixed by a board of arbitrators of three persons, to be appointed as follows: one by the State of Montana or the owner or lessee of the surface who is claiming damages, one by the lessee hereunder, and the third by the two arbitrators so appointed. The lessee hereby agrees to make prompt payment of the damages awarded by such board of arbitrators.

In any case where the owner of the surface claims title under a "C" patent issued by the State of Montana, and demands that the Board fix, allow and pay the owner the reasonable value of any right of way established by the lessee hereunder, the Department shall charge the cost of fixing the amount of damages to

the lessee hereunder. The lessee hereunder shall pay the reasonable sum so fixed as damages to the Board, which will pay the surface owner.

A-1. Lessee shall notify and obtain approval from the Department's Trust Land Management Division (TLMD) prior to constructing well pads, roads, power lines, and related facilities that may require surface disturbance on the tract. Lessee shall comply with any mitigation measures stipulated in TLMD's approval.

A-2. Prior to the drilling of any well, lessee shall send one copy of the well prognosis, including Form 22 "Application for Permit" to the Department's Trust Land Management Division (TLMD). After a well is drilled and completed, lessee shall send one copy of all logs run, Form 4A "Completion Report", and geologic report to TLMD. A copy of Form 2 "Sundry Notice and Report of Wells" or other appropriate Board of Oil and Gas Conservation form shall be sent to TLMD whenever any subsequent change in well status or operator is intended or has occurred. Lessee shall also notify and obtain approval from the TLMD prior to plugging a well on the lease premises.

Issuance of this lease in no way commits the Land Board to approval of coal bed methane production on this lease. Any coal bed methane extraction wells would require subsequent review and approval by the board.

When a well is proposed on a state oil & gas lease, the lease requirements A-1 and A-2 are triggered. The oil & gas lessee submits a request for TLMD review, as the lessor. They also send a request for regulatory review and approval to the MBOGC. The reviews conducted by MBOGC and TLMD utilize the same well proposal information, but the reviews are for distinct purposes.

The MBOGC reviews the well proposal for proper design and engineering to ensure the operation is safe and protective of surface and groundwater resources, consistent with board requirements to protect correlative rights of other mineral owners, and justified for prudent development the resource (in other words to prevent the drilling of unnecessary wells).

Upon receipt of the request for review, the TLMD sends letters and related information to our oil & gas lessee, advising them of the field office contact that will be conducting the review. This information also advises of their obligation to consult and coordinate with the surface owner or lessee, and to repair, replace or compensate the surface owner/lessee for any actual damages. If we own the surface and if the surface is leased, we provide contact information to the oil & gas lessee. We also send a letter and related information to our surface lessee. Copies of these letters and related information are attached.

The Minerals Management Bureau within TLMD coordinates the review process with the field office. The bureau also reviews lease status and applicable regulatory spacing requirements to ensure other lease requirements are met – primarily lease status, ensuring the lease agreement covers the area and target formations, and that the proposed well is consistent with the lessee's obligation to diligently develop and protect our correlative rights as the mineral owner.

The field office land use specialist consults with both the oil & gas company and surface lessee to: 1) ensure communication and coordination among all parties; review the proposed operation and require modifications as appropriate to reasonably minimize surface impacts; 3) prepare the environmental review pursuant to MEPA; 4) ensure surface damage coordination and compensation has been addressed, and; 5) send site-specific stipulations to the Minerals Management Bureau for inclusion in the division's

approval letter. The end product from this review is submittal from the field office to the Minerals Management Bureau of an approved environmental assessment and summary memo recommending certain site-specific stipulations, as appropriate. The Minerals Management Bureau then prepares a letter authorizing the oil & gas lessee to proceed with the proposed well, subject to any stipulations contained in the letter. A copy of a typical approval letter is attached.

If you should have any questions, please contact me at either (406) 444-3843 or mmason@mt.gov.

Attachments:

- Surface Owner Damage and Disruption Compensation Act
- State of Montana Oil and Gas Lease
- Initial Letters to surface and oil & gas lessees
- Surface damage forms and information
- Sample approval letter

TITLE 82. MINERALS, OIL, AND GAS
CHAPTER 10. OIL AND GAS -- GENERAL PROVISIONS

Part 5. Surface Owner Damage and Disruption Compensation

82-10-501. Purpose -- legislative findings. (1) The purpose of this part is to provide for the protection of surface owners of land underlaid with oil and gas reserves while allowing for the necessary development of those reserves.

(2) To carry out the purpose described in subsection (1), the legislature finds that:

(a) it is necessary to protect the economic well-being of individuals engaged in agricultural production;

(b) exploration for and development of oil and gas reserves in this state, while necessary, interferes with the use, agricultural or otherwise, of the surface of certain land; and

(c) owners of the surface estate should be justly compensated for use of their property and interference with the use of their property due to oil and gas development.

History: En. Sec. 1, Ch. 199, L. 1981.

82-10-502. Definitions. As used in this part, the following definitions apply:

(1) "Agricultural production" means the production of any growing grass, crops, or trees attached to the surface of the land or farm animals with commercial value.

(2) "Oil and gas developer or operator" means the person who acquires the oil and gas lease for the purpose of extracting oil and gas.

(3) "Oil and gas estate" means an estate in or ownership of all or part of the oil and gas underlying a specified tract of land.

(4) "Oil and gas operations" means the exploration for or drilling of an oil and gas well that requires entry upon the surface estate and is begun subsequent to June 1, 1981, and the production operations directly related to the exploration or drilling.

(5) "Surface owner" means the person who holds record title to or has a purchaser's interest in the surface of the land.

History: En. Sec. 2, Ch. 199, L. 1981.

82-10-503. Notice of drilling operations. In addition to the requirements for geophysical exploration activities governed by Title 82, chapter 1, part 1, the oil and gas developer or operator shall give the surface owner and any purchaser under contract for deed written notice of the drilling operations that he plans to undertake. This notice shall be given to the record surface owner and any purchaser under contract for deed at their addresses as shown by the records of the county clerk and recorder at the time the notice is given. This notice shall sufficiently disclose the plan of work and operations to enable the surface owner to evaluate the effect of drilling operations on the surface owner's use of the property. The notice shall be given no more than 90 days and no fewer than 10 days before commencement of any activity on the land surface.

History: En. Sec. 3, Ch. 199, L. 1981; amd. Sec. 27, Ch. 526, L. 1983; amd. Sec. 1, Ch. 497, L. 1985.

82-10-504. Surface damage and disruption payments -- penalty for late payment. (1) (a) The oil and gas developer or operator shall pay the surface owner a sum of money or other compensation equal to the amount of damages sustained by the surface owner for loss of agricultural production and income, lost land value, and lost value of improvements caused by drilling operations.

(b) The amount of damages may be determined by any formula mutually agreeable between the surface owner and the oil and gas developer or operator. When determining damages, consideration shall be given to the period of time during which the loss occurs.

(c) The surface owner may elect to receive annual damage payments over a period of time, except that the surface owner shall be compensated by a single sum payment for harm caused by exploration only.

(d) The payments contemplated by this subsection (1) may only cover land directly affected by drilling operations and production. Payments under this subsection (1) are intended to compensate the surface owner for damage and disruption; no person may reserve or assign that compensation apart from the surface estate except to a tenant of the surface estate.

(2) An oil and gas developer or operator who fails to timely pay an installment under any annual damage agreement negotiated with a surface owner is liable for payment to the surface owner of twice the amount of the unpaid installment if the installment payment is not paid within 60 days of receipt of notice of failure to pay from the surface owner.

History: En. Sec. 4, Ch. 199, L. 1981; amd. Sec. 2, Ch. 497, L. 1985; (2)En. Sec. 3, Ch. 497, L. 1985.

82-10-505. Liability for damages to property. The oil and gas developer or operator is responsible for all damages to property, real or personal, resulting from the lack of ordinary care by the oil and gas developer or operator. The oil and gas developer or operator is responsible for damages to property, real or personal, caused by drilling operations and production.

History: En. Sec. 5, Ch. 199, L. 1981.

82-10-506. Notification of injury. To receive compensation under this part, a surface owner shall give written notice to the oil and gas developer or operator of the damages sustained by the surface owner within 2 years after the injury occurs or would become apparent to a reasonable man.

History: En. Sec. 6, Ch. 199, L. 1981.

82-10-507. Agreement -- offer of settlement. Unless both parties provide otherwise by written agreement, within 60 days after the oil and gas developer or operator receives notice of damages pursuant to 82-10-506, he shall make a written offer of settlement to the person seeking compensation for the damages. The surface owner seeking compensation may accept or reject any offer.

History: En. Sec. 7, Ch. 199, L. 1981.

82-10-508. Rejection -- legal action. If the person seeking compensation receives a written rejection, rejects the offer of the oil and gas developer or operator, or receives no reply, that person may bring an action for compensation in the district court of the county in which the damage was sustained.

History: En. Sec. 8, Ch. 199, L. 1981.

82-10-509 through 82-10-510 reserved.

82-10-511. Remedies cumulative. The remedies provided by this part do not preclude any person from seeking other remedies allowed by law.

History: En. Sec. 9, Ch. 199, L. 1981.

State of Montana OIL AND GAS LEASE

No. _____

THIS INDENTURE OF LEASE, entered into between the State of Montana, through its Board of Land Commissioners, hereinafter referred to as lessor, and the person, company, or corporation herein named, hereinafter referred to as lessee, pursuant to the provisions of Title 77, Chapter 3, Part 4, M.C.A., and all acts amendatory thereof and supplementary thereto, WITNESSETH:

1. GRANTING CLAUSE--The lessor, in consideration of the annual rentals herein stated, the receipt of which for the first year of this lease is hereby acknowledged, the royalties to be paid, and the covenants to be kept and performed by the lessee, hereinafter set forth, hereby grants, demises, leases and lets to the lessee, for the purpose of mining and operating for oil and gas, and of laying pipelines, building tanks, power stations, and other structures thereon necessary in order to produce, save, care for, dispose of and remove the oil and gas, all the lands herein described, as follows:

Date this lease takes effect:

Name of Lessee:

Address:

Land Located in:

County:

Description of land:

Total number of acres, more or less, _____, belonging to _____ Grant.

Annual rental, payable each year in advance:

2. TERM AND HORIZONTAL SEGREGATION--This lease is granted for a primary term of ten years and so long thereafter as oil and gas in paying quantities shall be produced from the land, subject to all of the terms and conditions herein set forth; provided, however, that:

- (a) The extended term of this lease shall apply only to those formations discovered, developed or drilled during the primary term of ten years, and the interest of the lessee in the premises herein described shall thereafter be limited to such formations.
- (b) If oil and gas in paying quantities is discovered in an offset well on a contiguous section during the extended term of this lease in any formation in the zone between the deepest formation to which the lessee drilled during the primary term of this lease and the deepest formation in which oil or gas has been discovered on the leased premises, this lease shall terminate as to said zone unless, within 60 days after the completion of such offset well, the lessee shall commence operations to test such a formation.

IT IS MUTUALLY UNDERSTOOD, AGREED AND COVENANTED BY AND BETWEEN THE PARTIES TO THIS LEASE AS FOLLOWS:

3. LEASE EXTENSION--The Board of Land Commissioners may grant reasonable extensions of the primary term of this lease upon a showing that lessee, despite due care and diligence, is or has been directly or indirectly prevented from exploring, developing, or operating this lease or is threatened with substantial economic loss due to litigation regarding this lease or another lease in the immediate area held by the lessee, state compliance with the Montana Environmental Policy Act, or adverse conditions caused by natural occurrences.

4. LAND DISPOSITIONS--The lessor expressly reserves the right to sell, lease, or otherwise dispose of any interest or estate in the lands hereby leased, except the interest conveyed by this lease. However, lessor agrees that sales, leases, or other dispositions of any interest or estate in the lands hereby leased shall be subject to the terms of this lease, and shall not interfere with the lessee's possession or rights hereunder.

5. RENTAL--The lessee shall pay to the lessor an annual money rental in the amount hereinabove stated being not less than one dollar and fifty cents (\$1.50) for each acre of land held under this lease from year to year, provided, however, that the amount of such money rental so payable shall in no case be less than one hundred dollars (\$100.00) per annum. The first year's rental must be paid before the issuance of the lease. The rentals for each subsequent year of the lease shall be due and payable before the beginning of such subsequent lease year. Upon failure to make the rental payment, the lease terminates unless there is a well currently being drilled, a producing well, or a shut-in well approved by the Department of Natural Resources and Conservation, Trust Land Management Division (Department) on the lease. Rental paid for any year must be credited against any royalty that accrues during that year.

6. ROYALTY ON OIL--The lessee shall pay in money or in kind to the lessor at its option as hereinafter provided during the full term of this lease a royalty of 16.67%, free of all costs and deductions, on the average production of the oil from producing wells under this lease for each calendar month.

7. ROYALTY ON GAS--The lessee shall also pay in money or in kind to the lessor at its option as hereinafter provided during the full term of this lease, free of costs and deductions, a royalty on the gas produced from the wells under this lease whether the wells produce oil and gas or gas alone, of 16.67%.

8. SHUT IN GAS ROYALTY--The royalty on gas, including casinghead gas and all gaseous substances not sold or used off the premises, must be at the rate of \$400 per lease each year or the amount of the annual rental provided in the lease, whichever is the greater, payable on or before the annual anniversary date of the lease. As long as the leased lands contain a well capable of production in paying quantities and the requisite payment is made, the lease must be considered as a producing lease under the terms herein.

9. ROYALTIES BASED ON PRODUCTION--All royalties shall be calculated upon the total amount produced and saved under this lease exclusive of oil and/or gas used for light, fuel or operating purposes in connection with the work on the lands under the lease.

10. FULL PRODUCTION REQUIRED--All wells under this lease shall be so drilled, maintained and operated as to produce the maximum amount of oil and/or gas which can be secured without injury to wells and the aforesaid royalties shall be based and calculated on such full production of oil and/or gas.

11. ROYALTY PAYMENT--The lessee shall pay to the lessor in cash for such royalty oil and gas at the rate of the posted field price therefor existing on the day such oil or gas was run into any pipeline or storage tank to the credit of the lessee plus any bonus or other increase in price actually paid or agreed to be paid to the lessee.

12. IN-KIND OIL OR GAS--At the option of the lessor exercised not more frequently than once every thirty days by notice in writing the lessee shall deliver the State's royalty oil or gas free of cost or deductions into the pipeline to which the wells of the lessee may be connected or into any storage designated by the State and connected with such wells. The lessee shall not be required to furnish storage for the State's royalty oil for more than thirty (30) days following the date of production thereof when a market therefor is available.

13. FAIR MARKET VALUE--In all cases where there is no posted field price for oil or gas produced under this lease, the payments in cash for the royalties payable hereunder shall never be less than the fair market value thereof, for oil, at the wells where produced on the day it is run into the pipeline or storage tanks, and for gas, at the well where produced on the day produced. It is agreed that helium gas, carbon dioxide gas, and all other natural gases are included under the term "gas" as used in this lease.

14. LIENS ON PRODUCTION--The lessor shall have a first lien upon all oil or gas produced from the lands leased hereunder, to secure the payment of all unpaid royalty and other sums of money that may become due under the terms herein.

15. POOLING AND UNITIZATION--Upon receiving the written consent of the lessor, the lessee shall have the right to commit the lands hereby leased to a pooling, unit, cooperative or other plan of development or operation with other State lands, Federal lands, privately-owned lands or Indian lands. Such agreements shall not change the percentage of royalties to be paid to the state from the percentages as fixed herein. Oil or gas produced from any lands included in such an agreement which encompasses the lands hereby leased are considered to be produced from the lands hereby leased.

16. FARM LOAN ACQUISITIONS--If the land under this lease is "mortgaged land" acquired by the State in connection with a mortgage given to the State as security for a loan and such mortgage land has been sold by the State subsequent to July 1, 1927, and prior to February 26, 1929, the lessee shall pay directly to the holder of such land under certificate of purchase or other contract, or deed from the State, a royalty of one percentum (1%) of the oil and gas produced from such land to be calculated on the same basis and in the same manner as the royalty to be paid to the State, but the said royalty of one percentum shall be deducted from the royalty to be paid to the State so that such one percentum royalty does not increase the total royalty to be paid under this lease, and if such mortgage land was sold by the State between March 15, 1935, and July 1, 1961, the lessee shall pay directly to the holder of such land under certificate of purchase or other contract or deed from the State, a royalty of six and one-fourth percentum (6¼%) of the oil and gas produced from such land to be calculated as hereinbefore specified.

17. DELAY DRILLING PENALTY--Unless this lease is surrendered, is terminated by lessee's failure to pay rentals when due, or is terminated by the Board of Land Commissioners because of the failure of the lessee to comply with the express and implied covenants of this lease, the Board of Land Commissioners may, in its discretion and as provided by law, cancel and terminate this lease upon the failure of the lessee (1) to commence within five (5) years of the effective date of this lease, drilling of at least one well upon the leased premises of such diameter and to such depth as may be necessary to make a reasonable test for oil and gas; or (2) pay in advance a delay drilling penalty of one dollar and twenty-five cents (\$1.25) per acre for the sixth year of the lease in addition to the annual rental; or (3) pay in advance a delay drilling penalty of two dollars and fifty cents (\$2.50) per acre per annum for the seventh through the tenth year of the lease in addition to the annual rental. The lessee shall notify the Department of the commencement of drilling of any well within five (5) days after the well is spudded in. The Board shall refund delay drilling penalties paid on a lease for any year in which the lessee commences drilling on that lease.

18. DRY HOLE CLAUSE--Following the termination of the fourth year of this lease, if the lessee drills a dry hole on the lease premises prior to discovery of oil or gas or if after discovery of oil or gas, production thereof in paying quantities ceases, the lease may be terminated by the Board unless the lessee (1) commences drilling of another well for oil and/or gas before the 7th year of this lease or second anniversary of the lease following completion of the well, whichever comes later, or (2) unless the lessee, on or before such anniversary date resumes payment of any delay drilling penalties imposed by the Board. For purposes of this lease "dry hole" is defined as a completed well which is not capable of producing oil and/or gas in paying quantities when completed.

19. DRILLING EXTENSION--If at the expiration of the primary term hereof oil or gas is not being produced from the lease premises in paying quantities, but the owner of the lease is then engaged in drilling on the premises for oil and gas, then the lease continues in effect so long as such drilling operations are being diligently prosecuted. If oil or gas is recovered from any such well drilled or being drilled at or after the expiration of the primary term hereof, the lease continues in effect so long as oil or gas in paying quantities is being produced from the leased premises.

20. DUE DILIGENCE--Upon completion of a commercially productive oil or gas well upon the leased premises, the lessee shall proceed with reasonable diligence to drill such additional wells to the depth of the formation found commercially productive, or to such depth as may be necessary to economically test, develop and operate the deposits discovered.

21. OFFSET PROTECTION--The lessee shall commence promptly and diligently drill to completion all wells necessary on the lands under this lease in order to fairly offset commercially producing oil or gas wells on contiguous lands or pay a compensatory royalty.

22. WASTE PROHIBITED--In conducting all explorations, mining or drilling operations under this lease, the lessee shall exercise all reasonable care and precautions in order to prevent waste of oil and gas. The lessee shall also at all times use all reasonable care and precautions to prevent the entrance of water to the oil or gas bearing strata to the destruction or injury thereof.

23. LOGS REQUIRED--The lessee agrees to keep a correct log of each well drilled under this lease, showing the formations passed through, the depth at which such formation was reached, the thickness of each formation, the water-bearing formations and the character of water therein, the elevations to which the water rises, the number of feet of casing set in such well and where placed, its size and the total depth to which such well was drilled; and upon request, to file the log with the Department.

24. PROGRESS REPORTS REQUIRED--When called upon to do so, the lessee shall also file progress reports with the Department before the completion or abandonment of any well.

25. PRODUCTION REPORTS AND PAYMENT OF ROYALTY--The lessee further agrees on or before the last day of each month to make a report to the Department for operations covering the preceding calendar month, which report shall be in such form as the Department may prescribe and shall show the amount of oil or gas produced and saved during the preceding calendar month, the price obtained therefor, the total amount of all sales, whether any bonus or other increase in price was actually paid or agreed to be paid and such additional information as may be required. Such report shall be signed by the lessee or by some responsible person having knowledge of the facts contained therein. The report shall be accompanied by payment of the amount due the State as royalty for the month covered by the report where payment is required in money in place of oil or gas.

26. COMPLETION REPORTS REQUIRED--When the lessee is required by the rules of the Board of Oil and Gas Conservation to file a well completion report with that board, lessee shall file one copy of that report with the Department.

27. LESSOR'S RIGHT TO INSPECT--Representatives of the lessor shall at all times have the right to enter upon the granted premises and all parts thereof for the purpose of inspecting and examining the same, as well as supervising tests that they may deem necessary to ascertain the condition of the wells being drilled or about to be abandoned and gauging the production of producing wells. Representatives of the lessor shall also, at all reasonable hours, have free access to all books, accounts, records and papers of the lessee insofar as they contain information relating to the production obtained under this lease, the price obtained therefor, and the fair market value of the production. Lessor shall also have free access to agreements relating to production hereunder.

28. SURFACE OWNER'S OR LESSEE'S RIGHTS--The lessee hereunder agrees to provide the surface owner and surface lessee with a plan for location of all facilities and consult with the surface owner and surface lessee regarding a reasonable location of access roads. In all operations on the land hereby leased, lessee agrees to interfere as little as possible with the use of the premises for any other purpose to which the same may be devoted by other persons to whom the land may have been leased or sold by the State. The lessee shall not drill any well upon the lands hereby leased, within two hundred feet (200') of any residence or barn now or hereafter erected

thereon without the consent of the owner of such building. The lessee hereby agrees to make satisfactory adjustment with the owner or lessee of the surface, including the State of Montana, for damages sustained by such surface owner, the lessee, or the State of Montana by reason of the lessee's entry upon, use and occupancy of, the surface of the land. If amicable determination of damages cannot be made between such surface owner, lessee, or the State of Montana and the lessee hereunder, then, upon the agreement of the surface owner or lessee to enter into arbitration, the damages to be paid to the surface owner or lessee shall be fixed by a board of arbitrators of three persons, to be appointed as follows: one by the State of Montana or the owner or lessee of the surface who is claiming damages, one by the lessee hereunder, and the third by the two arbitrators so appointed. The lessee hereby agrees to make prompt payment of the damages awarded by such board of arbitrators.

In any case where the owner of the surface claims title under a "C" patent issued by the State of Montana, and demands that the Board fix, allow and pay the owner the reasonable value of any right of way established by the lessee hereunder, the Department shall charge the cost of fixing the amount of damages to the lessee hereunder. The lessee hereunder shall pay the reasonable sum so fixed as damages to the Board, which will pay the surface owner.

29. ASSIGNMENTS--The lessee may assign this lease either in whole or as to any regular subdivision thereof, embracing not less than forty (40) acres, to any qualified assignee, providing that such assignment shall not be binding upon the State until it has been filed with the Department accompanied by the required fees. No assignment to two or more assignees will be approved until one of the assignees is designated to act as agent for the assignees.

30. RELINQUISHMENTS--The lessee shall have the right at the termination of any rental year, by giving at least thirty (30) days previous notice in writing to the Department, to surrender and relinquish any legal subdivisions of the land hereby leased and thereupon be discharged from any obligation not theretofore accrued as to the lands so surrendered and relinquished. When this lease terminates as to any portion less than the whole of the lands covered hereby, because of the lessee's failure to pay rental when due, lessee agrees to submit to the lessor, within thirty (30) days after such termination, a written surrender and relinquishment of those lands.

31. CANCELLATION--It is understood and agreed that the lessor hereby reserves the right to declare this lease forfeited and to cancel the same through the Board of Land Commissioners upon failure of the lessee to fully discharge all the obligations provided herein, after written notice from the Board and reasonable time fixed and allowed by it to the lessee for the performance of any undertaking or obligation specified in such notice concerning which the lessee is in default. The lessee, upon written application therefor, shall be granted a hearing on any notice or demand of the Board before the lease shall be declared forfeited or canceled. The provisions of this clause shall not in any way affect an automatic termination of this lease caused by lessee's failure to pay rental when due.

32. SURRENDER POSSESSION--Upon the termination of this lease for any cause the lessee shall surrender possession of the leased premises to the lessor subject to lessee's right to re-enter, hereby granted, at any time within six months after the date of such termination, for the purpose of removing all machinery, fixtures, improvements, buildings and equipment belonging to the lessee remaining upon the premises except casing in wells and other equipment or apparatus necessary for the preservation of any oil or gas well or wells. It is hereby agreed that any succeeding lessee, or in the event there be no succeeding lessee, the lessor, wishing to have such property left permanently upon the premises, shall pay the reasonable value thereof, in cash, to the lessee, but if the succeeding lessee or the lessor, acting through its Board of Land Commissioners, shall be unable to agree with the lessee upon the reasonable cash value of such casing, equipment and apparatus, then the succeeding lessee or the lessor herein, as the case may be, shall pay in cash to the lessee hereunder, such sum as may be fixed as a reasonable price by a board of three appraisers, one of whom shall be chosen by the succeeding lessee or the State of Montana as the case may be, one by the lessee hereunder, and the third by the two chosen, and whose appraisal shall be reported to the respective parties, in writing, and is final and conclusive. If the lessee or succeeding lessee refuses to appoint an appraiser within fifteen (15) days of a request to do so by the Department, the Department may appoint an appraiser for the lessee or succeeding lessee. Unless the Department gives written authorization, the lessee may not remain in possession or manage the land and property formerly covered by the lease. During the time the lessee remains in authorized possession, the lessee shall be entitled to retain the same share of the products of the lands as inured to the lessee during the term of this lease. Should the lessor herein or any succeeding lessee not desire any of the lessee's property permanently left upon the premises, as provided in this paragraph, the lessee shall properly plug all non-producing wells and remove all of his property from the lands with reasonable diligence. If any of the property of the lessee is not removed from the leased premises within six months of the termination date of the lease as herein provided the same shall be deemed forfeited to the State of Montana and shall become its property.

33. COMPLIANCE WITH LAWS, RULES AND REGULATIONS--This lease is subject to further permitting under the provisions of Title 75 or 82, Montana Code Annotated. The lessee agrees to comply with all applicable laws, rules and regulations in effect at the date of this lease, particularly the Rules Governing the Issuance of Oil and Gas Leases on State Lands of the State of Montana. The lessee agrees to comply with all applicable laws, rules and regulations which may, from time to time, be adopted and which do not impair the obligations of this contract and which do not deprive the lessee of an existing property right recognized by law.

34. WARRANTY OF TITLE--It is understood and agreed that this lease is issued only under such title as the State of Montana may now have or hereafter acquire, and that the lessor shall not be liable for any damages sustained by the lessee, nor shall the lessee be entitled to or claim any refund of rentals or royalties theretofore paid to the lessor in the event the lessor does not have the title to the oil and gas in the leased lands. If the lessor owns a lesser interest in the leased lands than the entire and undivided fee simple estate in underlying oil and gas for which rental and royalty is payable, then the rentals and royalties herein provided shall be paid the lessor only in the proportion which its interest bears to the whole and undivided fee simple estate in the oil and gas for which royalty is payable.

35. LEGAL FEES--In the event lessor shall institute and prevail in any action or suit for the enforcement of any provisions of this lease, lessee will pay to lessor a reasonable sum for costs incurred on account thereof.

36. SPECIAL PROVISIONS:

SEE EXHIBIT "A"

37. EXECUTING PARTIES BOUND--All covenants and agreements herein set forth between the parties hereto shall extend to and bind their successors, heirs, executors and assigns.

IN WITNESS WHEREOF, the State of Montana and the lessee have caused this lease to be executed in duplicate and the Director of the Montana Department of Natural Resources and Conservation, pursuant to the authority granted him by the Board of Land Commissioners of the State of Montana, has hereunto set his hand and affixed the seal of the Board of Land Commissioners this ____

day of _____.

Lessee

Address

Director of the Department of Natural Resources
and Conservation

Stipulations

1. Lessee shall notify and obtain approval from the Department's Trust Land Management Division (TLMD) prior to constructing well pads, roads, power lines, and related facilities that may require surface disturbance on the tract. Lessee shall comply with any mitigation measures stipulated in TLMD's approval.
2. Prior to the drilling of any well, lessee shall send one copy of the well prognosis, including Form 22 "Application for Permit" to the Department's Trust Land Management Division (TLMD). After a well is drilled and completed, lessee shall send one copy of all logs run, Form 4A "Completion Report", and geologic report to TLMD. A copy of Form 2 "Sundry Notice and Report of Wells" or other appropriate Board of Oil and Gas Conservation form shall be sent to TLMD whenever any subsequent change in well status or operator is intended or has occurred. Lessee shall also notify and obtain approval from the TLMD prior to plugging a well on the lease premises.

Issuance of this lease in no way commits the Land Board to approval of coal bed methane production on this lease. Any coal bed methane extraction wells would require subsequent review and approval by the board.

3. The TLMD will complete an initial review for cultural resources and, where applicable, paleontological resources of the area intended for disturbance and may require a resources inventory. Based on the results of the inventory, the TLMD may restrict surface activity for the purpose of protecting significant resources located on the lease premises.
4. The lessee shall be responsible for controlling any noxious weeds introduced by lessee's activity on State-owned land and shall prevent or eradicate the spread of those noxious weeds onto land adjoining the lease premises.
5. The definitions of "oil" and "gas" provided in 82-1-111, MCA, do not apply to this lease for royalty calculation purposes.

Note: The above lease stipulations are a part of every lease. Additional stipulations are added as appropriate based on the department's pre-lease review.

**DEPARTMENT OF NATURAL RESOURCES
AND CONSERVATION**

Trust Land Management Division



BRIAN SCHWEITZER, GOVERNOR

1625 ELEVENTH AVENUE

DIRECTOR'S OFFICE (406) 444-2074
TELEFAX NUMBER (406) 444-2684

PO BOX 201601
HELENA, MONTANA 59620-1601

SAMPLE SURFACE LESSEE LETTER

June 22, 2005

John S. Vassar
1401 6th Avenue West
Williston, ND 58801

RE: Summit Resources, Inc./True Oil Company
NWNW Section 16-T11N-R33E
Rosebud County, Montana

Dear Lessee:

The Department received notification that our oil and gas lessee intends to drill a well on the above referenced section. Your surface lease allows the Department to develop other resources on state land, including minerals such as oil and gas. However, you are entitled to receive compensation from the oil and gas lessee for any actual damages to your state surface lease. You will be contacted in the near future by the above referenced company or their agent regarding access on your state surface lease, including placement of roads, if any, across the surface lease to the drillsite. While the location of the drillsite may be limited by geologic, engineering or regulatory factors, related activities such as access routes or flowlines can often be coordinated to minimize impact to your state surface lease.

Your surface lease does not allow you to accept payments in excess of actual damages, or to charge for access on state land. However, the state oil and gas lease does not grant any access across non-state lands. A settlement form and information on calculation of surface damages is attached.

The oil and gas lessee will forward a copy of your damage settlement to the Department. Please contact our Area Land Office or me if you have any questions.

Sincerely,

Julie David, Supervisor
Mineral Leasing Section
Minerals Management Bureau

copy: Clive Rooney, Area Manager, NELO, DNRC, Lewistown, MT
Dan Dobler, Unit Manager, Havre Unit Office, DNRC, Havre, MT
Summit Resources, Inc., 717 17th Street, Suite 1500, Denver, CO 80202

DEPARTMENT OF NATURAL RESOURCES AND CONSERVATION

Trust Land Management Division



BRIAN SCHWEITZER, GOVERNOR

1625 ELEVENTH AVENUE

DIRECTOR'S OFFICE (406) 444-2074
TELEFAX NUMBER (406) 444-2684

PO BOX 201601
HELENA, MONTANA 59620-1601

SAMPLE OIL & LESSEE LETTER

June 22, 2005

Scott A. Kemmis
Contract Land Agent
Fidelity Exploration & Production Company
PO Box 1010
Glendive, Montana 59330-0131

RE: State of Montana Oil and Gas Lease #33,458-99
Township 3 South, Range 61 East
Section 36: All
Carter County, Montana
Montana State A-36-1-1A Well

Dear Lessee:

The Department received a letter and APD from River Gas Corporation requesting approval for a well on the above referenced state section. Enclosed is a copy of my letter to our surface lessee, Joseph T. Padden, advising of your responsibility to repair, replace or compensate the surface lessee for actual damages to their leasehold interest. The letter included the enclosed settlement form and information sheet on determining appropriate payment for actual damages for state surface lease activities. The surface lessee is not entitled to payments in excess of actual damages.

You will need to settle surface lessee damages and meet with our field office staff to settle state surface owner damage compensation. When the state is the surface owner, payment to the state is determined by calculating the difference between that paid to other surface owners in the area, less the amount paid to our surface lessee for actual damages to his leasehold interest. Forms are included for both surface lessee and state surface owner damage compensation.

I have requested an Environmental Assessment (EA) from our Havre Unit Office. It will depend on their workload and number of projects ahead of this request, as to how soon I will receive the EA. You need to notify our surface lessee and the Havre Unit Office before staking the well and work with them regarding the placement of any roads. Your contact is:

Dan Dobler, Unit Manager, Havre Unit Office, DNRC, 210 Sixth Avenue, P.O. Box 868,
Havre, MT 59501-0868, telephone (406) 265-5236

As soon as I receive the EA from our field office, Monte Mason, Minerals Management Bureau Chief, will review the information, and then we can give approval for the well and let you know if there are additional stipulations. Please let us know if you have any questions.

Sincerely,

Julie David, Supervisor
Mineral Leasing Section
Minerals Management Bureau

Enclosure

copy: Clive Rooney, Area Manager, NELO, DNRC, Lewistown, MT
Dan Dobler, Unit Manager, Havre Unit Office, DNRC, Havre, MT
Terry D. Burns, River Gas Corporation, Tuscaloosa, AL

DEPARTMENT OF NATURAL RESOURCES AND CONSERVATION

Trust Land Management Division



BRIAN SCHWEITZER, GOVERNOR

1625 ELEVENTH AVENUE

DIRECTOR'S OFFICE (406) 444-2074
TELEFAX NUMBER (406) 444-2684

PO BOX 201601
HELENA, MONTANA 59620-1601

OIL AND GAS SURFACE DAMAGE PAYMENTS

The Agricultural and Grazing Lease entered into by the surface lessee reserves and allows for the state to issue mineral leases. Like surface leases, a mineral lease requires various payments to the state, and conveys to its lessee the right to utilize the surface land. However, the mineral lessee is required to compensate for actual damages to the surface lessee's crops, improvements or leasehold interest. Damage payments are to be reasonably based on actual damage. Collection by the surface lessee of higher amounts unrelated to damages is not allowed. ARM 36.25.138 specifically provides as follows:

36.25.138 LESSEE OR LICENSEE DAMAGE COMPENSATION REQUIREMENTS

(1) When the board or department issues a lease or license on property upon which a lease or license of a different type already exists, the existing lessee or licensee shall be compensated by the more recent lessee or licensee for damages to the crops, improvements or leasehold interest of said existing lessee or licensee. **Lessees or licensees may not receive compensation for such damages in excess of the value of actual damages to the crops, improvements or leasehold interest of said existing licensee. Only in exceptional cases documented to and approved by the department may the lessee or licensee receive damages for natural resources or crops in excess of the annual rate that the lessee or licensee is making to the department for rental payments. If a lessee or licensee collects or attempts to collect an amount in excess of said actual damages, such action may constitute sufficient grounds for cancellation of the lease or license.** The department may adjust the AUM's allocated to a grazing lease or license when there is issued a lease or license for another purpose and that other purpose interferes with the grazing on the state lease. (History: 77-1-209, MCA; IMP, 77-1-202, MCA; NEW, 1987 MAR p. 17, Eff. 1/16/87; TRANS, 1996 MAR p. 2384.)

The oil & gas lessee is obligated to repair, replace or compensate the surface lessee for actual damages. Following is a brief explanation of how actual damages are typically calculated for various surface activities.

Grazing Land: If activities are to occur which prevent the surface lessee from utilizing AUMs already paid for, they would be entitled to be compensated for those AUMs. If future carrying capacity of the state lease is significantly impacted, the Department would adjust the AUM rating of the state surface lease for future years. Therefore, the surface lessee would not require any reimbursement from the oil and gas company for future years.

Crop Land: If activities are to occur which destroy crops in the ground, the surface lessee would be entitled to be compensated for the amount of revenue they would have received for those acres of crop removed by the oil and gas lessee. If crops are planted on a rotating basis, and if the surface lessee has invested prep-work on a fallow area for next year's crop (i.e.

(continued on other side)

plowing, seeding, spraying, or fertilizing), they would be entitled to compensation for such costs on those acres removed by the oil and gas lessee. Crop-related compensation is commonly calculated by prorating your field costs to a per-acre amount for the acres actually impacted.

CRP Land: If activities are to occur which cause a readjustment in the CRP contract, the oil and gas lessee is responsible for paying any contract reimbursement required by the Federal government, as well as paying the surface lessee for any reduction in CRP payments they would have received under the current contract.

For all types of land, the oil and gas company is responsible to repair, replace, or compensate the surface lessee for any damage done to lease improvements, such as fences, culverts, cattleguards, stockwater developments, irrigation developments, etc. Any permanent or long-term loss of production due to surface activity on the lease will be adjusted out of the surface lease at the earliest possible time so that the surface lessee is not paying the State for a use that is not available on the state land. Other special circumstances may exist which merit discussion with the Department.

The surface lessee cannot charge a fee solely for the right to conduct activities on state land, since the oil and gas lessee is paying the State of Montana for that right. However, the state oil and gas lease does not, in any way, grant any access rights across non-state lands. If such access is desired by the oil and gas company, that is a separate issue between the adjacent landowner and the oil and gas company.

The Department recognizes that the amount of actual damage may be relatively small, such as for small well sites on grazing land. As a practical matter, we recommend a minimum damage payment of \$100.00 per well site. Payments are to be made on a one-time basis; long-term settlements over a period of years are not acceptable. It is our expectation that our oil and gas and surface lessees will work together to coordinate activities and minimize impacts. Any disputes regarding surface operations or damage payments should be referred to the appropriate Area Land Office for settlement.

**SURFACE LESSEE
NOTICE OF SETTLEMENT OF DAMAGES**

TO: DEPARTMENT OF NATURAL RESOURCES
____ Unit or ____ Area Office
ADDRESS:

RE: State Lease # _____

I have been informed that _____
of _____ is applying
for department authorization under their oil & gas lease enter onto the
following State Lands:

for the purpose of _____
_____.

As the Lessee of the State Land described above, I/(we) understand that if the proposed activity is authorized by the department, that I/(we) as leaseholder am/(are) entitled to compensation for damages, that may occur to my/(our) improvements, crops, or leasehold interest.

I/(we) also acknowledge that the said compensation, if any, is for actual damages only and that compensation should not exceed the actual value of the damages to my/(our) improvements, crops or leasehold interest.

I/(we), the undersigned hereby state that

_____ No damages are anticipated.

_____ Damages are anticipated and compensation has been received based on anticipated damages.

_____ Damages are anticipated and arrangements have been made for compensation.

Amount of Damage Payment _____ (paid or arranged)

_____ Damages are anticipated and the applicant & I (we) are not able to agree on the value of the damages. Attached is a listing of my/(our) improvements, crops and/or statement of what portion of my/(our) leasehold interest will be damaged and my estimate of value for compensable damages.

Signed this _____ day of _____, 20____.

(Lessee)

(Lessee)

(Lessee)

(Lessee)

(NOTE: All persons named on the state surface lease must sign this settlement statement. If a person is signing on behalf of another, copies of a Power of Attorney must be provided. Additionally, if a person has signed on behalf of an estate, Personal Representative papers must also accompany this form.)

OIL & GAS SURFACE DAMAGE SETTLEMENT

Department of Natural Resources and Conservation

Trust Land Management Division

O&G LEASE # _____ TRS: _____ COUNTY: _____

STATE OWNS: ☐ Surface & Minerals ☐ Minerals Only

PROPOSED ACTIVITY: _____

SURFACE OWNER/LESSEE PAYMENT:

(Provide lessee settlement form or
other acceptable documentation)

DAMAGE SETTLEMENT DUE STATE:

(zero if the state does
not own the surface)

TOTAL DAMAGE SETTLEMENT:

The above payments are for settlement of damages anticipated from the proposed activity only, and do not constitute waiver by the oil & gas lessee or the State of Montana of any legal rights. If unanticipated damages should occur that exceed the amount of settlement already paid, the oil & gas lessee remains liable for repair, replacement or compensation covering the unanticipated damages.

I hereby certify that I am a lessee of record or an agent of the lessee of record, and that I am authorized to act on behalf of the lessee of record for the purpose of executing settlement of damages for the proposed activity. I acknowledge that damage settlement has been made pursuant to the Surface Owner Damage and Disruption Compensation Act (82-10-501 et seq., MCA), Administrative Rule (ARM 36.25.217(3) and 36.25.238)), and pertinent provisions of the oil & gas lease.

Signed this _____ day of _____, 20 _____

Oil & Gas Lessee or Agent: _____ Phone #: _____

By: _____

Address: _____

Accepted by the State of Montana
Trust Land Management Division

Area/Unit Office: _____

Address: _____

(Information on Back)

INSTRUCTIONS

- (1) Fill out oil & gas lessee, location, county.
- (2) Check whether state owns surface and minerals or just minerals. The state does not receive settlement for surface damages if it does not own the surface. However, use of this form documents the contact and compensation made to the owner of the surface.
- (3) Provide brief description of proposed activity.
- (4) As provided in 82-10-504(1)(b) MCA, determine with oil & gas lessee or their agent, by any formula mutually agreeable, the total settlement appropriate for the proposed activity. This will typically include the nature and extent of the activity, and the amounts being paid in the area for similar activity to owners of the surface.
- (5) Document settlement amount provided to surface owner or lessee. If we do not own the surface, the amount paid to the surface owner will equal the total settlement amount for surface damages, leaving zero due to the state. If the state owns the surface and the surface is leased, the oil & gas lessee should have already contacted the surface lessee and made payment for damages pursuant to administrative rule (provided below). The settlement amount due the state will then be the difference between the total settlement payment and the payment to the surface lessee.
- (6) Oil & gas lessee or their agent will fill in contact information, sign and date the form. Upon receipt of payment due the state, fill in area/unit office information and execute the form.
- (7) Forward the original form with documentation to the Mineral Leasing Section Supervisor. Include payment or advise if deposited locally.

RELATED STATUTES

Surface Owner Damage and Disruption Compensation Act (82-10-501 et seq., MCA)

(Copy available upon request)

ADMINISTRATIVE RULES RELATING TO DAMAGE PAYMENTS ON STATE LEASES

36.25.217 OPERATIONS ON STATE LEASES . . .

(3) To minimize conflicts with the owner or lessee of the surface of the land leased, lessee hereunder shall:

(a) provide the surface owner or lessee with a plan for location of all facilities;

(b) consult with the surface owner or lessee regarding a reasonable location of access roads. The access roads must be located along section lines and existing roads to the fullest extent possible and they must disturb as little acreage as possible unless the surface owner agrees otherwise. In locating the roads, priority shall be given to minimizing interference with the surface owners or lessees operations. The lessee shall make just payment to the surface owner for all damage done by reason of his entry upon, and use and occupancy of, the surface of the land.

. . .

36.25.138 LESSEE OR LICENSEE DAMAGE COMPENSATION REQUIREMENTS (1) When the board or department issues a lease or license on property upon which a lease or license of a different type already exists, the existing lessee or licensee shall be compensated by the more recent lessee or licensee for damages to the crops, improvements or leasehold interest of said existing lessee or licensee. Lessees or licensees may not receive compensation for such damages in excess of the value of actual damages to the crops, improvements or leasehold interest of said existing licensee. Only in exceptional cases documented to and approved by the department may the lessee or licensee receive damages for natural resources or crops in excess of the annual rate that the lessee or licensee is making to the department for rental payments. If a lessee or licensee collects or attempts to collect an amount in excess of said actual damages, such action may constitute sufficient grounds for cancellation of the lease or license. The department may adjust the A.U.M.'s allocated to a grazing lease or license when there is issued a lease or license for another purpose and that other purpose interferes with the grazing on the state lease.

DEPARTMENT OF NATURAL RESOURCES
AND CONSERVATION
TRUST LAND MANAGEMENT DIVISION



BRIAN SCHWEITZER, GOVERNOR

1625 ELEVENTH AVENUE

STATE OF MONTANA

DIRECTOR'S OFFICE (406) 444-2074
TELEFAX NUMBER (406) 444-2684

PO BOX 201601
HELENA, MONTANA 59620-1601

October 4, 2005

Omimex Canada, Ltd.
65 East Broadway, Suite 401
Butte, Montana 59701

RE: State of Montana Oil and Gas Lease OG-31138-94
Township 33 North, Range 22 East
Section 16: Lots 1, 2, 3, 4, W½, W½E½
Blaine County, Montana
SE Cherry Patch #15-16 Well (SWSE)

Dear Lessee:

Please accept this letter as approval to drill the above referenced well, construct an access road to the well site, and install a pipeline on State of Montana Oil and Gas Lease OG-31138-94 with the following site-specific stipulations. Please refer to your oil and gas lease for general operational and reclamation requirements.

1. Lessee shall contact the Havre Unit Office at (406) 265-5236, 48 hours prior to any surface activity.
2. Lessee shall contact the state's surface lessee, Thomas E. Green, 48 hours prior to any drilling activity. Lessee shall settle all surface damages within a reasonable time period following the completion of the well.
3. Permittee shall be responsible for controlling all weeds around the well site, access road, and pipeline route on this tract of state grazing land.
4. In order to prevent the introduction of noxious weeds on this tract of state land, all equipment used on this project must be initially power washed prior to use.
5. Drilling activity may occur on dry or frozen ground only. No activity will be allowed during muddy conditions.
6. No vehicle oil changes or petroleum disposal shall occur on this tract of state land.

Omimex Canada, Ltd.

October 4, 2005

Page 2

7. There will be no off-road traffic other than that necessary to accomplish well drilling and construction of an access road to the well site.
8. All gates will be closed and all fences that are taken down will be repaired as soon as possible.
9. The topsoil removed from the site must be located upslope from the project. Subsoil, excessive dirt, and pit stockpiles must be located down-slope from the project.
10. The access road must be kept to a minimal size in order to minimize the impact to the native rangeland resource. Turn-arounds must be kept to their initial size and are not to be expanded. The tear drop must be as close to the drill pad as possible.
11. All disturbed areas shall be seeded with State of Montana Certified or Registered seed. The seed mixture shall be planted in the amounts specified in pounds of pure live seed per acre (PLS/acre). The seed mixture shall consist of 5 lbs. PLS/acre 'Rosana' western wheatgrass, 5 lbs. PLS/acre 'Pryor' slender wheatgrass, 6 lbs. PLS/acre 'Lodorm' green needlegrass, and 2 lbs. PLS/acre yellow sweetclover (seed poundage is to be doubled if area is broadcast seeded). The seeding will be repeated until a satisfactory stand is established as determined by the Havre Unit Office.

Please send this Department a copy of your surface lessee damage settlement as soon as it is available. After the well has been drilled, please send this Department a copy of your completion report and geologic information. If you have any questions, let us know.

Sincerely,



Monte G. Mason, Chief
Minerals Management Bureau

copy: Clive Rooney, Area Manager, NELO, DNRC, Lewistown, MT
Dan Dobler, Unit Manager, Havre Unit Office, DNRC, Havre, MT
Dale Stoodley, Montana Land & Exploration Inc., Calgary, Alberta, Canada
Trent Sizemore, Lonewolf Energy, Inc., Billings, MT